

IN THE
Supreme Court of the United States

OCTOBER TERM, 1944

THE CITY NATIONAL BANK AND TRUST COMPANY, TRUSTEE,
UNDER TRUST AGREEMENT WITH HAMILTON DEPOSITORS
OF HAMILTON TRUST SHARES, PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES
CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT
AND BRIEF IN SUPPORT THEREOF.

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vs.

COMMISSIONER OF INTERNAL REVENUE.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES
CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT.

The City National Bank and Trust Company, Trustee,
Under Trust Agreement with Hamilton Depositors of
Hamilton Trust Shares, petitioner, respectfully prays for
a writ of certiorari to review the judgment of the United
States Circuit Court of Appeals for the Tenth Circuit
entered May 13, 1944 (R., p. 290). Rehearing denied July
7, 1944 (R., p. 292).

JURISDICTION

The jurisdiction of the Court is invoked under Section
240(a) of the Judicial Code as amended by the Act of
February 13, 1925.

QUESTIONS PRESENTED

(1) Whether a fixed investment trust is an association taxable as a corporation.

(2) Whether the determination of the Tax Court that the fixed investment trust here involved was not an association taxable as a corporation—a determination based on undisputed evidentiary facts of: Individual beneficial ownership as distinguished from group ownership of the underlying assets; impossibility of any common or group gain or loss; holding of the assets by the trustee for the preservation of the property and the collection of income for the owners; and lack of resemblance to corporate form;—whether its determination based on these evidentiary facts can be overturned because the Court of Appeals draws an opposite inference from the same evidence.

(3) Whether in a typical step transaction the determination of the Tax Court that the payment of dividends on the underlying stocks through the trustee to the beneficial owners of those stocks shall for tax purposes be treated as a single transaction, can be overturned because the Circuit Court on the same evidence deems the steps should be separated and a tax be levied on each.

(4) Whether the determination of the Tax Court that the trust is not a common enterprise for the transaction of business and sharing of gains but that the collection and distribution of income and other acts of the trustee are but incidental to the holding and conservation of the corpus, can be overturned by the Circuit Court because it draws a different inference from the same evidence.

(5) Whether if the trust is an association taxable as a corporation the dividends received on the underlying securities, being the sole income, can be taxable as net income, since the Circuit Court concedes that the very receipt of the dividends by the trustee creates a corresponding indebtedness to the beneficial owners of those underlying stocks.

(6) Whether there was substantial evidence to sustain the determination of the Tax Court.

STATEMENT

Petitioner is the trustee of the typical periodic payment fixed investment trust* here involved and has sole authority to protect the trust estate against unlawful tax claims (R., p. 128). Hamilton Depositors Corporation (hereinafter referred to as "Hamilton") is a kind of broker that sells its services to numerous small investors at a compensation specified in its agreement (certificate) with each of them. It selected a list of thirty of the leading stocks on the New York Stock Exchange and recommends the list as an investment (R., p. 105). It does not sell the stocks because it owns none, but it agrees with the investor that it will take his money, buy the stocks for him and deposit them with the trustee** (R., pp. 106, 107, 139), who will in turn pay him the dividends received thereon less its charges or reinvest them for him at his option in units of the same stocks (R., pp. 13, 114, 149, 150). A unit is one share of each of the thirty named stocks and 1/1000 of a unit is termed a "beneficial interest" (R., p. 12). The principal service rendered by Hamilton is that of enabling the small investor to purchase an undivided interest in the specified list of stocks and so diversify his investment, though he has not the money to purchase full shares of each stock (R., p. 141). The investor receives from Hamilton a "certificate" which is an agreement to invest whatever he pays in from time to time in those specified stocks (R., p. 106) and authorizes Hamilton to deduct its fees (R., pp. 110, 111). This is the only certificate the investor receives (R., p. 12). It does not specify how much he has

*There is no power of substitution (R., p. 16), but is power in Hamilton to eliminate any undesirable stock. None have ever been eliminated (R., p. 16). In case of elimination, reinvestment is limited to units of remaining stocks (R., p. 16).

**Certificate (R., p. 106)—"That the investor shall pay to the Corporation the sum of \$..... payable in the following manner:
* * * That, pursuant to the terms * * * the said Corporation covenants and agrees to purchase with the funds applicable therefor from the payments received from the Investor * * * ."

invested or what interest he has or will have in the underlying securities purchased by the trustee. He has a bank book in which those items are entered in terms of "beneficial interests" from time to time as he makes payments for investment (R., p. 12). There is nothing in the record to sustain the court's statement that the certificates are listed on the Stock Exchange. They are not of the type that could be listed, nor are they negotiable (R., p. 19). Each investor buys an interest in the underlying stocks themselves—not in an entity which owns the underlying stocks.* When the money is paid in, usually in small installments, it is used with the money of other investors to purchase the specific stocks named** (R., p. 16), in which he immediately acquires an undivided interest (measured in beneficial interests) which is credited to him on the books of the trustee bank (R., p. 16). One investor has no relationship whatever to any other except that each employs Hamilton to perform these services for him and each owns an undivided interest in the stocks held by the trustee.

When these underlying stocks so purchased pay dividends to the trustee in whose name they stand, the trustee is obligated to credit quarterly each investor with his share thereof (R., pp. 13, 14), deductions therefrom being authorized only in the amounts agreed on by the investor in the certificate on account of services to him of Hamilton and the trustee. The very receipt of these dividends by the trustee creates under the contract the obligation to pay them to the individuals who own the undivided interests (R., p. 114). The Circuit Court itself so finds (R., p. 289). Neither the trustee nor Hamilton nor the group as a whole has any right to use this income as capital or for any purpose whatever. Each investor may withdraw his share of the securities or require its sale and the payment to him of the proceeds thereof (R., p. 20), or if he can find another person who is willing in writing to assume the obligations and payments specified in the certificate (R.,

*One share of each of the thirty named stocks.

**See Appendix, p. 32.

p. 19), he may sell and assign his entire certificate to that individual.*

The trustee holds the trust property in its vaults, collects the income thereon and distributes it according to the agreement to the owners of the individual interests—after deduction of fees. The income here sought to be taxed is all income so collected by the trustee for distribution to the individual beneficial owners thereof (Ex. 13, R., pp. 209, 229; Ex. 15, R., p. 253).

The Circuit Court of Appeals held that the trust resembles a corporation and that there is an association here taxable as a corporation and that all of the income of each of the individual investors derived from their individual share of the securities must be lumped into one sum on which the government will levy a corporate income and an excess profits tax.

In the entire history of the trust, since its commencement in 1931 to the date of trial, there have been purchased and deposited in trust with the trustee 2,859 shares of each of the thirty stocks named in the portfolio. (No others.) (85,770 shares in all.) *The only sale of stock ever made was a sale of six shares of each of the stocks (180 shares in all) in 1934 at the request of Harry Jackson, the owner of undivided interests equal to that many shares.* All the rest are still held by the trustee (R., p. 32). The entire proceeds of the sale went to Jackson (R., p. 17), no other investor realized or could realize a dime from the sale and financially it was wholly immaterial to each and all of them whether the stock sold at a high price or a low price, because it was Jackson's stock and not the stock of any entity, enterprise or group—just as is every other share of the underlying securities held in the trust.** The

*"The investors have never held a meeting of any kind and as a group have not had officers, directors, or a governing body, or used a minute book and seal. The investors received nothing to indicate the amount of their beneficial interest in the underlying securities, save the entry in the deposit record book." Findings of Tax Court (R., p. 19).

** (R., p. 36): "There is no profit to the corporation, the trustee, or the certificate holders as a group. * * * any profit from liquidations go to the investor who requests the liquidation. The distribution of dividends goes to each individual investor's account."

group and enterprise are unaffected and can suffer no loss and no gain by any sale. Jackson was entitled to all the proceeds. This was in exact compliance with the requirements of the agreement held by each investor. The Circuit Court found as a fact that the trust was an enterprise for the purchase and sale of stock—overruling the Tax Court's determination to the contrary.

STATUTE INVOLVED

The statute involved is as follows:

Internal Revenue Code, Sec. 3797 (a) (3): "*Corporation.*—The term 'corporation' includes association, joint-stock companies, and insurance companies."

The tax provisions as to corporations are not in dispute.

RULING OF THE TAX COURT AND OF THE COURT BELOW

The Tax Court in a memorandum opinion entered on March 8, 1943, not reported but appearing in the Record (pp. 11-21) found for petitioner, holding that the trust here involved was not an association taxable as a corporation. It said (R., pp. 20, 21):

"The present proceeding is so essentially similar to *The Chase National Bank of the City of New York, as Trustee*, 41 B. T. A. 430, affirmed (C. C. A., 2nd Cir.), 122 Fed. (2d) 540, that we have no difficulty in concluding that the result reached should normally be the same. *The Board there held that investment trusts of the fixed or non-discretionary type in which the managers 'were not given and did not * * * exercise any powers beyond those which are necessary incidents to the preservation of trust property, the collection of income therefrom, and its distribution to the holders of trust shares' are not associations taxable as corporations.* Not only is that a principle to which the Board has committed itself and in which it was there upheld on review but it has subsequently reaffirmed its position in an unpublished opinion and again been affirmed by a different circuit. *Commissioner v. Buck*

ley (C. C. A., 9th Cir.), 128 Fed. (2d) 124. A District Court in still another circuit has arrived at the same conclusion. *Equitable Trust Co. v. Magruder* (U. S. D. C., D. of Md.), 37 Fed. Supp. 711.

"Such embarrassment as there is in the present proceeding arises from the circumstance that the single authority taking the opposite view is one which involves this petitioner, and which was handed down by the circuit to which the present proceeding will go for review. *Hamilton Depositors Corp. v. Nicholas* (C. C. A., 10th Cir.), 111 Fed. (2d) 385. *That case, however, is not conclusive by virtue of any principle of res judicata as is conceded, it being stated that counsel for the present parties 'both concluded that under the Supreme Court decision in the Nunnally case (United States v. Nunnally Investment Co., 316 U. S. 258) the point of res adjudicata couldn't be raised in this case.'* Since, however, it is in our view impossible successfully to distinguish the *Chase National Bank case*, it thus appears inescapable that there is a conflict. Only resort to the Supreme Court or possibly to legislation can lay the matter finally at rest. It will not improve the situation for us to follow diametrically opposite views depending upon the circuit to which an appeal will lie. And with the greatest deference to the court which decided the *Hamilton Depositors Corporation case*, the desirability of a shift of position on our part to conform with that result does not appear sufficiently imperative to justify the overturn of decisions of the Board which have now been affirmed in two circuits. *We feel constrained, therefore, to adhere to the position adopted in the Chase National Bank case and to disapprove the deficiency on the authority thereof.*" (Italics supplied.)

The Circuit Court of Appeals reversed the Tax Court (R., p. 282) 142 Fed. (2d) 771 (advance sheets). It held that the trust was a business trust, saying (R., p. 290):

"* * * The trust clearly was engaged in the business of buying and selling securities for income

and profit for its members. Its structure, while not identical to that of a corporation, was measurably akin thereto. Being an association in the nature of a corporation, it falls within the provisions of the act and is taxable accordingly."

The court further said (R., p. 289):

"* * * It is true that if the trustee receives income from the underlying securities, its receipt creates a corresponding indebtedness to the individual beneficiary and that the beneficial interest of the underlying securities was in the beneficiaries. But that is not decisive of the nature of the association. The legal title to the securities was in the trustee and the legal title to the income or profit in the first instance was likewise in the trustee. The moment when the legal title to the income passes to the beneficiaries is immaterial. The title must pass through the trustee. All the trustee ever has in the corpus of an estate or in the income therefrom is the naked legal title. The beneficial legal interest is always in the beneficiaries. This result flows from the very nature of a trust. The fact that one may have realized a gain and another a loss as a result of a sale of stock because they purchased on a different level does not change the nature of the association. It still is an association in which the beneficiaries join together for the common purpose of realizing profit and gain through the operation of the trust."

Petition for rehearing was filed on the 31st day of May, 1944, and denied on July 7, 1944.

REASONS FOR GRANTING WRIT

1. The Circuit Court of Appeals held that a fixed investment trust without power of substitution of securities is an association taxable as a corporation. This is in accord with the recent decision of the Third Circuit in *Pennsylvania Co. v. United States*, 138 Fed. (2d) 869 (decided November 16, 1943) and is contrary to the settled rule of the Tax Court and to decisions of the Second and Ninth

Circuits—*Commissioner v. Chase National Bank*, 122 Fed. (2d) 540 (C. C. A. 2), and *Commissioner v. Buckley*, 128 Fed. (2d) 124 (C. C. A. 9) decided May 8, 1943. The United States District Court for the District of Maryland in *Equitable Trust Co. v. Magruder*, 37 Fed. Supp. 711, holds with the Tax Court and with the Second and Ninth Circuits that it is not an association taxable as a corporation.

2. The Circuit Court held that though the beneficial ownership of the underlying securities rested in the individual beneficiaries in undivided interests and though the very receipt of the income by the trustee created a corresponding indebtedness to the individual beneficial owners, yet it must be taxed as a corporation as though the beneficial ownership was in the group rather than in the individual. This is in conflict with *Morrissey v. Commissioner*, 296 U. S. 344, which held that only where the trust property was to be used as capital for the transaction of business and the sharing of its gains was the trust taxable as a corporation. The Circuit Court failed to distinguish between the beneficial ownership of capital by an entity as in a corporation and beneficial ownership by the individual owners of undivided interests in the trust property which characterizes a trust. It is also in conflict with the settled principle of tax law as expounded by the Court of Appeals for the District of Columbia in *112 West 59th Street Corporation v. Helvering*, 68 Fed. (2d) 397, and *Central Life Assur. Soc. v. Commissioner*, 51 Fed. (2d) 939 (C. C. A. 8), which hold that only the beneficial owner is taxable.

3. The Circuit Court has overturned the fact determinations of the Tax Court that the trust was not given and did not exercise powers other than were necessary to the preservation of the trust property, the collection of income therefrom and its distribution to the owners thereof; that the trust was not a medium for the conduct of business and sharing its gains and was not an association taxable as a corporation. The Circuit Court has inferred from the evidence that it was engaged in the business of buying and selling stocks for profit. There was substantial evi-

dence to support the findings of the Tax Court and the Circuit Court is without power to substitute its judgment for that of the Tax Court. Its action is in conflict with *Dobson v. Commissioner*, 320 U. S. 489; *Commissioner v. Heininger*, 320 U. S. 467; *Wilmington Trust Co. v. Helvering*, 316 U. S. 164; *Colorado Nat. Bank of Denver v. Commissioner*, 305 U. S. 23; *Hulburd v. Commissioner*, 296 U. S. 300; *McCaughn v. Real Estate, Land Title & Trust Co.*, 297 U. S. 606; *Elmhurst Cemetery Co. of Joliet v. Commissioner*, 300 U. S. 37; *Neal v. Commissioner*, 53 Fed. (2d) 806 (C. C. A. 8); *Commissioner v. Sharp*, 91 Fed. (2d) 804 (C. C. A. 3)—which hold final the determination of the Tax Court in such matters.

4. The Circuit Court has held that the payment of dividends on the underlying securities to the beneficial owners thereof through a trustee must be separated into two taxable transactions, the dividends being taxed on payment to the trustee as though they beneficially belonged *en masse* to a group or association and again being taxed to the individual owners when received by them. This is contrary to the finding of the Tax Court which held, in effect, that the trustee was a mere conduit and that the transaction should be synthesized for tax purposes into a single one involving payment only by each individual owner on his own share of the dividends. The Circuit Court was without power to substitute its judgment for that of the Tax Court in that matter under *Dobson v. Commissioner*, *supra*, which held that the power to determine whether transactions shall be synthesized or separated for tax purposes rests with the Tax Court and not with the regular courts.

5. The question involved as to the meaning of the statute in its application to investment trusts is one of great public importance.* If the Circuit Court of Appeals' decision is correct and the Supreme Court so finds, large

*The Securities & Exchange Commission in its 1940 report on "Fixed and Semi-Fixed Investment Trusts" states that \$99 millions of dollars of securities had been sold under the fixed trust plan up to 1936—the peak of the fixed trust. University of Denver Business Review, June, 1930, lists all investment trusts as in excess of 3 billion dollars in value.

amounts of revenue otherwise unavailable, particularly in the Second and Ninth Circuits, will be collected by the government. If the Tax Court and the Second and Ninth Circuits are right and the Tenth and Third Circuits are wrong, then the government is wrongfully penalizing the many thousands of owners of interests in fixed investment trusts in the Tenth and Third Circuits.† Hundreds of millions of dollars have been invested by thousands of investors throughout the United States in various types of investment trusts. The courts are in a state of complete confusion as to the meaning of the *Morrissey* case, *supra*, in relation thereto. The sixteen judges of the Tax Court have consistently ruled as it did in this case without dissent. The District Court and two of the Circuit Court judges in the Second Circuit ruled with the Tax Court. The District Court and two of the Circuit Court judges in the Ninth Circuit ruled with the Tax Court. The District Court in Maryland ruled with the Tax Court. The District Court and three of the Circuit Court judges in the Third Circuit ruled against the Tax Court and the District Court and three of the Circuit Court judges in the Tenth Circuit ruled against the Tax Court. Yet, apparently no effort has ever been made by the government to obtain certiorari to have this matter finally determined by the United States Supreme Court—a fact forcibly commented on by the Ninth Circuit in *Commissioner v. Buckley*, *supra*.*

Moreover, it is of great importance that the Tax Court and the Circuit Courts and the Treasury Department should be advised whether the Supreme Court is going to make effective its ruling in the *Dobson* case, *supra*, as to the finality of the Tax Court's findings or is going to recede therefrom. The Circuit Court in this case has over our earnest protest ignored that decision.

The ruling here and the Treasury regulation** asserting the taxability as corporations of all investment trusts—

†The little investment trust here involved has 7,500 investors.

* (p. 125): "The Commissioner did not seek certiorari in the *Chase Nat. Bank* case although he claims the decision was wrong. His funda-

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fixed and management alike—regardless of beneficial ownership of the trust property—stand in flat contradiction to the most elementary principles of tax law, to the settled rule of the Tax Court and to the Circuit Court decisions above referred to. This creates a situation detrimental to the fair administration of the tax laws and adds measurably to the already existing confusion. It ought to be resolved in the interest of the public and the Treasury alike.

CONCLUSION

For these reasons it is respectfully submitted that the petition should be granted.

Respectfully submitted,

THE CITY NATIONAL BANK AND TRUST
COMPANY, TRUSTEE, UNDER TRUST
AGREEMENT WITH HAMILTON DEPOSITORS
OF HAMILTON TRUST SHARES.

By MORRISON SHAFROTH,

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(Continued from Page 11)

mental thesis is that for tax purposes all investment trusts should be classified as corporations. If the Commissioner is correct in this, it would seem that the courts have been expending much useless labor on the subject." (Italics supplied.)

**Treasury Regulations 101, Art. 901-2. "Association.—The term 'association' is not used in the Act in any narrow or technical sense. * * * It includes a voluntary association, a joint-stock association or company, a 'business' trust, a 'Massachusetts' trust, a 'common law' trust, an 'investment' trust (whether of the fixed or the management type) * * *."

